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CABINET AFFAIRS STAFFING MEMORANDUM

Date: 4/10/84 Number: 168961CA Due By:

Subject: Cabinet Council on Commerce and Trade - April 11, 1984

10:00 A.M.

REMARKS:

There will be a meeting of the Cabinet Council on Commerce and Trade on Wednesday, April 11, 1984 at 10:00 A.M. The meeting is tentatively scheduled to be held in the Roosevelt Room. The agenda is as follows:

- Update on the Auto Industry (background paper attached)
 - Update on the Steel Industry (background paper attached)

RETURN TO:

Craig L. Fuller
Assistant to the President
for Cabinet Affairs
456-2823

Katherine Anderson Don C.
 Tom Gibson Larry H.





THE SECRETARY OF COMMERCE
Washington, D.C. 20230

MEMORANDUM FOR: Cabinet Council on Commerce and Trade

FROM: Secretary of Commerce

SUBJECT: Report on the U.S. Automobile Industry

This memorandum seeks your support in a major Administration effort to oppose automotive domestic content legislation in the Senate. In addition, it provides background information on the status of the U.S. automobile industry and describes expected issues in the single most important event this year for the U.S. industry--negotiation of labor contracts at GM and Ford.

DOMESTIC CONTENT LEGISLATION

Domestic Content legislation (H.R. 1234) passed the House on November 3. The vote was 219-199, a much narrower margin than in 1982. The Senate bill (S. 707) is substantially identical, though it lacks several studies added by floor amendments in the House. It has 17 cosponsors, and is now before the Committee on Commerce, Science, and Transportation. Chairman Bob Packwood (R-OR) has announced an ambitious schedule of hearings on the legislation. These hearings will be:

May 16: Washington
May 24: Washington
May 29: Portland, Oregon
July 6: Des Moines, Iowa
To be Announced: Michigan (probably Detroit or Flint in June)

The hearing schedule is designed to dramatize the breadth of opposition to the proposal in those areas of the country where domestic content could have clear impact. The extensive hearings are also designed to discourage attempts to propose domestic content as a floor amendment to other legislation before the Senate. The 100 member private sector coalition organized to oppose domestic content is working very closely with Senator Packwood to ensure a full list of witnesses at each hearing.

Senator Packwood and the private organizations believe that such a large effort is needed to impose as many barriers as possible before the supporters of the bill. We agree.

Organized labor has indicated that domestic content is one of its highest priorities for 1984. Both Lane Kirkland, President of the AFL-CIO, and Owen Bieber, President of the U.A.W., have been making personal contact with Senators. Ford and Chrysler actively supported domestic content before the floor vote in the House. They wish to keep the measure alive to force the Administration to agree to pressure the Japanese Government to extend its limit on car exports beyond March 1985. (An extended restraint program would facilitate joint venture negotiations both Ford and Chrysler have underway with Japanese companies as well as provide insurance should Ford have to agree to a generous wage contract to avoid a strike.) Finally, Vice President Mondale and Senator Hart have made support of domestic content a major issue in the primary debates.

The danger is that these pressures could result in a version of domestic content reaching the Senate floor for a symbolic vote later in the year. The debate on protection of the auto industry may be further complicated by the number of Section 201 cases now before the International Trade Commission (Tuna, Footwear, Stainless Steel Flatware, Copper, Specialty Steel). Any recommendations for relief the ITC may make will be before the President in August and September.

Broad Administration participation in the upcoming hearings could be the key factor in opposing domestic content. On April 6, the Assistant Secretary for Congressional and Intergovernmental Affairs at Commerce met with his counterparts from the Departments of State, Treasury, Agriculture, and Transportation, the White House, and USTR. They agreed to contact key Senators by May 1. In addition, they agreed to recommend to their principals that each send a letter to the full Senate. The Commerce Department letter will be sent this week.

The group also discussed the hearing schedule. Senator Packwood has asked that a Cabinet Member testify at each session to show the strength of the Administration's opposition. We think that the level of Administration participation will be a very strong signal. If we appear, it will show a united front. If the Administration does not participate at a high level, for scheduling or other reasons, it could encourage the proponents of the bill in the belief that our opposition has weakened.

Recommendation:

We recommend that each CCCT member contact Senator Packwood to indicate a willingness to testify if a mutual accommodation can be made on the schedule.

AUTO INDUSTRY PERFORMANCE

Summary

Last year was a time of significant accomplishment for the domestic auto industry. Sales recovered strongly, improving 17 percent over 1982. Improvements in cost structure, the continuation of contracts that helped contain the growth of labor costs, the end of rebate and other discount programs, strong sales of larger, more expensive models, and continued limits on Japanese imports all combined to produce a record profit of \$6.15 billion. Employment at the end of 1983 increased about 120,000 over 1982 to 734,000. Industry profits in the first quarter should be about \$2.7 billion. For 1984 as a whole, the industry should earn \$9-10 billion. Employment increased an additional 7,000 by the end of the first quarter. For the year, it will be almost 40,000 above 1983's level.

Yet, the industry still faces difficult problems in 1984 and beyond. The 1980-82 recession so weakened corporate balance sheets that more than two years of healthy profits will be needed to reduce debt and increase working capital. Until the companies are in sound financial condition, a sales downturn in the next two or three years could result in a new round of losses, plant closings, and layoffs. At the same time, there is strong pressure from shareholders and all employees to obtain greater rewards. For example, UAW contracts at GM and Ford must be renegotiated by September 30. The union is seeking full restoration of wage and benefit levels that were limited in the 1981 contracts in addition to a large increase in base wages. All of these pressures detract from the needed investment in new automotive products to compete in future markets.

Sales

Total 1983 motor vehicle sales increased by 17% over 1982 after four consecutive years of declines. Passenger car sales increased by about 15% and truck sales increased 24 percent. While strong, total motor vehicle sales were still about 8% below the level of 1978, the last previous healthy sales year.

Cars

U.S. passenger cars increased over 1982, from about 8.0 million units to 9.2 million units. Sales of domestic cars increased by 17 percent from 5.8 million units in 1982 to 6.8 million units in 1983. Sales of imported cars increased 7 percent, from 2.2 to 2.4 million units. Japanese car sales increased from about 1.8 million units to about 1.9 million units as Japanese manufacturers increased their shipments during the first three quarters of the restraint year in order to meet increased demand. The large increase in domestic sales and the much smaller growth in imports produced a decline in import penetration from 27.9 percent in 1982 to 26.0 percent in 1983. The market share held by Japanese cars fell even more, from 22.5 percent in 1982 to 20.4 percent in 1983.

As fuel prices stabilized in 1983, a predictable event occurred in the market. Sales of intermediate and large cars increased from 2.9 million units in 1982 to 3.8 million units in 1983. Sales of domestic compact cars declined from 1.1 million units in 1982 to 0.9 million units in 1983. This disproportionate increase in sales of intermediate and large cars illustrates that the large car buyer has returned to the market. These buyers are traditionally blue collar workers who normally provide the bulk of sales increases as a recession ends. During 1983 there was concern in the industry that the large car sales trend could result in fines being levied on GM and possibly Ford in 1985 for exceeding corporate average fuel economy (CAFE) standards. Actions by EPA to liberalize fuel economy test requirements and the introduction of new, fuel-efficient GM luxury models have reduced the possibility of actual fines, but the Department of Transportation continues to follow the situation closely.

Total first quarter sales were 10.6 million units on a seasonally adjusted annual basis. For the year, based on a conservative reading of sales and economic trends, we project total industry sales of 10.4 million units, 12 percent above 1983's.

Trucks

Light truck sales in 1983 increased to nearly 3.0 million units -- a 25 percent increase from the 2.4 million units sold in 1982. Sales of U.S.-made compact pick-up trucks increased from 334,000 units in 1982 to 427,000 in 1983. Despite this increase, sales of noncaptive Japanese pick-up trucks increased even more and their share of the compact pick-up truck market rose from 42 percent in 1982 to 46 percent in 1983. Nevertheless, this is well below the 90 percent share held in 1981. Sales in the sport/utility segment increased by about 220,000 units. This increase was largely accounted for by a 205,000 unit gain in sales of compact size vehicles (Blazer, Bronco II, etc.).

Chrysler and Toyota introduced compact vans in the U.S. market in 1983. Sales totalled 21,000 units by year end. Orders have far exceeded production and Chrysler reportedly has a backlog of orders for over 100,000 units.

For the year, we project total industry light-duty truck sales of 3.2 to 3.4 million units, a 7 to 13 percent increase over 1983.

Employment

Industry employment indicators improved greatly by the end of 1983. Industry employment increased from 685,000 at year end 1982 to 734,000 by the end of 1983. For first quarter, employment rose to an estimated 741,000, and for the year should be around 770,000. While this is a substantial improvement, employment is still far below the 1.03 million workers which the industry averaged in 1978. Due to productivity improvements (illustrated by a 31 percent improvement in 1983 production over 1982 levels with only a 15 percent increase in employment), industry employment is unlikely to return to 1978 levels.

Labor Contracts

The most important event of the year for the industry will be renegotiation of the U.A.W. contracts with GM and Ford. These negotiations will begin in early summer, and are expected to conclude before the contracts expire in September.

The wages, fringe benefits, and working conditions that emerge from these negotiations will have a number of major effects on the industry. Labor costs could increase significantly. As a result of the contract it signed in September 1983, for example, Chrysler's labor costs in the United States are expected to rise about 20 percent from \$21 to \$26 per hour over the next two years. Chrysler's settlement was just to catch up to GM and Ford. Their settlements will build upon this base and could be even more generous.

Ironically, as labor costs go up, there is a long-term incentive for the companies to reduce those costs through automation and outsourcing; eventually costing jobs.

Based upon the opening position of the union, in every significant area of cooperation and restraint in the 1981 contract, the U.A.W. is seeking a reversal to at least the 1979 levels. U.A.W. leadership, unlike two years ago, is urging its members to resist pleas to cooperate. The union leadership has discouraged any public discussion of a strike this year. Nevertheless, a strike is one of the most popular topics at the local levels and the auto companies are very worried.

Financial

The industry's financial condition improved dramatically in 1983. The results were a record profit of \$6.15 billion and substantial improvements in the industry's financial condition. Based on continued strong sales in the first quarter of this year, we estimate earnings for the quarter to be around \$2.7 billion, and for the year \$9 to \$10 billion.

But the companies' balance sheets still have not returned to pre-1980 conditions. When 1983 industry profits are converted to constant 1972 dollars, they total \$2.85 billion, far below 1977 earnings of \$3.67 billion when measured on the same basis. As can be seen in Table I, the industry had a return on sales in 1983 of 4.54 percent vs. 4.76 percent in 1977. This was a strong performance, but it was not sufficient to restore the damage done to corporate balance sheets during the 1980-1982 period. The industry average return on sales for 1980-83 was 0.4 percent.

TABLE I

RETURN ON SALES
for period ending December 31 of each year

	<u>1977</u>	<u>1978</u>	<u>1979</u>	<u>1980</u>	<u>1981</u>	<u>1982</u>	<u>1983</u>
Revenue (\$m)	\$108,099	\$122,364	\$125,019	\$105,967	\$113,506	\$97,458	\$135,620
Net Inc./Loss	\$ 5,144	\$ 4,950	\$ 3,037	\$ (4,216)	\$ (388)	\$ 322	\$ 6,156
RETURN ON SALES	4.76%	4.05%	2.43%	-3.98%	-0.34%	0.33%	4.54%

The current ratio (current assets to current liabilities) is still far from returning to pre-1980 levels (Table II). Industry-wide this ratio stood at 1.55 in 1978. It reached a period low of 1.01 in 1982 and improved to 1.19 by the end of 1983. Working capital stood at \$5.7 billion at the end of 1983, less than half of the \$12.3 billion in 1978. Even this may underestimate the severe decline in working capital since all of the companies have taken drastic steps to preserve working capital, such as reclassifying short-term debt and restructuring pension obligations.

TABLE II

CURRENT RATIO
as of December 31 of each year

	<u>1978</u>	<u>1979</u>	<u>1980</u>	<u>1981</u>	<u>1982</u>	<u>1983</u>
General Motors	1.79	1.68	1.26	1.09	1.13	1.40
Ford	1.33	1.25	1.14	1.16	0.84	1.05
Chrysler	1.43	0.97	0.94	1.08	1.12	0.80
AMC	1.29	1.42	1.69	1.48	1.10	1.01
TOTAL	1.55	1.40	1.18	1.07	1.01	1.19

The quick ratio (Table III) measures the proportion of current liabilities covered by cash and cash equivalents of the industry. It implies the industry's ability to respond to sudden changes in the market. Of all these ratios, this one is the closest to the 1978 level. The severe cash leverage of the industry caused the quick ratio to drop from 0.73 in 1978 to 0.42 in 1981. By the end of 1983 it had risen to 0.70. This is because the industry's first priority has been to restore its cash position.

TABLE III

QUICK RATIO
as of December 31 of each year

	<u>1978</u>	<u>1979</u>	<u>1980</u>	<u>1981</u>	<u>1982</u>	<u>1983</u>
General Motors	0.89	0.81	0.61	0.40	0.48	0.88
Ford	0.64	0.53	0.50	0.47	0.38	0.57
Chrysler	0.45	0.30	0.26	0.34	0.54	0.39
AMC	0.61	0.64	0.47	0.47	0.30	0.33
TOTAL	0.73	0.62	0.52	0.42	0.44	0.70

The long-term debt to equity ratio (Table IV) further illustrates the industry's deteriorated condition. From a ratio of 0.11 in 1978 it rose to 0.37 by the end of 1982. By December 31, 1983, it had improved to 0.24 but still stood at twice the 1978 level and it now contained debt acquired at high interest rates in 1980-1982. Thus it understates the true effect of the debt on the companies.

TABLE IV

LONG TERM DEBT-TO-EQUITY RATIO
as of December 31 of each year

	<u>1978</u>	<u>1979</u>	<u>1980</u>	<u>1981</u>	<u>1982</u>	<u>1983</u>
General Motors	0.06	0.05	0.11	0.21	0.24	0.15
Ford	0.12	0.12	0.24	0.37	0.39	0.36
Chrysler	0.41	0.54	5.41	2.64	2.17	0.81
AMC	0.22	0.24	0.26	0.84	2.38	2.27
TOTAL	0.11	0.10	0.24	0.34	0.37	0.24



THE SECRETARY OF COMMERCE
Washington, D.C. 20230

**MEMORANDUM FOR MEMBERS OF THE CABINET COUNCIL
ON COMMERCE AND TRADE**

From: Malcolm Baldrige, Chairman Pro Tempore
Subject: State of the U.S. Steel Industry

This memorandum provides an overview of the state of the industry and steel import trends. I have also summarized recent steel trade policy and antitrust policy developments.

Condition of the Industry

The U.S. steel industry appears to be emerging from its worst recession since the 1930's. The current economic recovery is having a major stimulative impact on the industry. Increased demand in the automotive and consumer appliance markets gradually pushed steel production levels upward in the latter half of 1983. In the first few months of 1984, improved demand in the capital goods sector combined with continuing growth in the consumer goods sector to provide considerable impetus to steel industry recovery.

Data Resources, Inc. (DRI) has forecast 1984 U.S. apparent steel consumption to be 93 million tons, a 10 percent increase from 1983. The major contributing market is the automotive sector, forecast to be up 3.3 million tons from 1983 and 6.5 million tons from 1982. Other major markets in which consumption is projected to increase are industrial and electrical machinery (up 1.5 million tons from 1983) and construction and contractors products (up 1 million tons). No major market is expected to decline.

Peter Marcus, steel industry analyst for Paine Webber, reports that new orders exceeded the 7 million ton level in both January and February. These continue to favor sheet producers, although orders for plates and structural shapes have also begun to improve. Marcus estimates that delivery lead times are now stretched to six to seven weeks for hot-rolled sheets and eight to ten weeks for some coated sheets.

As a result of the increased demand, virtually all indicators of steel industry activity are up, and some are up sharply. Operating at 55 percent of its raw steel production capability in 1983, the steel industry's utilization rate rose to 69 percent in January, 76 percent in February and 79 percent for the week ending March 24. DRI projects capability utilization to be 82 percent in the second

quarter, a moderate seasonal decline in the third and fourth quarters, and a return to rates above 80 percent in 1985. While these rates reflect reduced capability estimates^{1/}, they also reflect improved production levels. The 23 million tons of raw steel produced in the first 12 weeks of this year were 37 percent above the total for the same period in 1983. Production surpassed 2 million tons in each of the five weeks prior to March 24 -- the highest level since the week ending October 17, 1981.

Even employment data are beginning to reflect the turnaround, although continued industry rationalization will rule out any dramatic improvement in this measure of activity. Net wage and salaried employment in January stood at 241,000 workers. While this is a slight decrease from fourth quarter 1983 levels, it represents a 5 percent increase over January 1983. Nevertheless, the number of laid-off workers remains high -- at 84,000 by the end of January.

Recent Trends in Imports

Imports of basic steel mill products reached 2.08 million tons in January and 2.16 million tons in February. Import penetration rose to 26.1 percent in January. With February imports being the second highest monthly total ever recorded, February import penetration could reach a record-breaking 27 percent. Imports in the first two months of 1984 were 87 percent above the first two months of 1983 and 19 percent above the comparable period of 1982.

Imports from all sources contributed to the increase. Comparing the first two months of 1983 and 1984, imports increased by 51 percent from the European Community (EC), 91 percent from Japan, 119 percent from Canada and 101 percent from all other countries. Imports from sources other than EC, Japan and Canada accounted for 41 percent of the aggregate increase from January-February 1983 to January-February 1984.

While the strong dollar continues to be an important factor, economic recovery is probably the leading cause of the upswing in imports. Sheet imports destined for the automotive and appliance markets grew 105 percent from the first two months of 1983 to the first two months of 1984. Sheets alone accounted for 42 percent of the total import increase over the two two-month periods. Structural shape imports rose by 133 percent over this same period, reflecting the continued strength of the construction industry and improved activity in the capital goods sector in general.

Increased imports from certain developing countries and other "non-traditional" suppliers are a major reason for the overall rise in imports. However, imports have also increased recently from

1/ Production capability estimates were lowered by 400,000 tons per week in 1984 to reflect the closure of about 24 million tons of capacity since 1977.

suppliers whose exports to the United States had abated in 1983. Higher imports from Japan reflect increased U.S. demand, but they also reflect the tendency of Japanese producers to "bunch" their exports at the end of quarterly and annual periods. Higher imports from the EC reflect efforts by Community producers to fill underutilized annual export quotas under the U.S.-EC Steel Trade Arrangement. These exports are only now being recorded in U.S. import statistics because of transportation and reporting time lags. Recent Japanese export data indicate that imports from that country will decrease in coming months, and the commencement of the 1984 Arrangement period should also cause imports from the EC to moderate.

Steel Trade Policy Developments

Much of the import increase from countries other than the EC, Japan and Canada is covered by pending unfair trade investigations. There are currently 26 antidumping (AD) and 16 countervailing duty (CVD) cases at various stages of investigation by the Department of Commerce (DOC) and the International Trade Commission (ITC). These cases involve 13 different steel products variously imported from 11 countries.

Imports from Brazil are the subject of 2 AD and 3 CVD investigations now under way, and another CVD case which may be initiated on April 10. Other countries facing multiple investigations for unfair trade include Mexico, Argentina, Spain and South Africa. Imports of 6 South African steel products will be subject to preliminary AD determinations on July 19.

The U.S.-EC Arrangement on Certain Steel Products continued to operate effectively throughout 1983. EC import penetration fell to 4.9 percent in 1983, significantly below the 7.4 percent market share it held in 1982. While the Pipe and Tube Arrangement has succeeded in reducing the level of EC pipe and tube exports from pre-Arrangement levels, DOC is continuing to work with the EC to achieve greater compliance with the Arrangement's 5.9 percent import penetration ceiling. On April 6, DOC and EC officials held formal consultations in Brussels, and the EC will respond to the concerns raised by DOC when both sides meet again this week.

Despite the success of the U.S.-EC Arrangement and the multiplicity of unfair trade investigations, the domestic steel industry is pressing for five years of comprehensive import relief through global quotas. On January 24, Bethlehem Steel and the United Steelworkers (USW) filed a petition with the ITC under Section 201 of the Trade Act of 1974, seeking quotas on imports of carbon, alloy and certain fabricated steel products. If ITC finds that increased imports have been a substantial cause of serious injury in any or all product lines, it must forward these findings with a remedy recommendation to the President by July 24. The President would then have until September 24 to decide what remedy, if any, were appropriate. To date, no other major U.S. producer has come forward to support the Bethlehem/USW petition.

The industry as a whole does support legislation in both the House (H.R. 5081) and the Senate (S. 2380) to limit steel imports to approximately 15 percent of the U.S. market for five years. Banking on election year pressures, the American Iron and Steel Institute has initiated a major lobbying effort to garner support for these bills. Hearings on the House version are tentatively scheduled to begin April 26.

Mergers

In March, the Justice Department announced its approval of a revised merger proposal submitted by the LTV Corporation and Republic Steel. Under the revised proposal, LTV and Republic agreed to sell certain facilities so that the structure of the post-merger firm could satisfy Justice's concerns about preventing excessive market concentration in specific product lines.

Justice's approval of the revised LTV-Republic proposal is an encouraging sign for steel industry restructuring and for the industry's ability to adapt to changed circumstances. The issue, however, is broader than whether the antitrust laws permit a particular merger to go through on the basis of a specific set of facts. We must continue to examine current merger guidelines to determine if they sufficiently recognize the significance of imports in the domestic market and increasing competition in the world marketplace.